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TORONTO, May 25, 1983 The Federal-Provincial Tax Collection Agreement is being seriously threatened by disharmony, and this could lead to the provinces 'going-it-alone'.

A background study prepared for the Ontario Economic Council calls for more and immediate co-operation between the two levels of government to preserve tax harmony in Canada.

The report, A SEPARATE PERSONAL INCOME TAX FOR ONTARIO: AN ECONOMIC ANALYSIS, says the province of Ontario should NOT set up its own PIT (personal income tax) system.

It suggests there are reasons why Ontario might want to consider its own PIT, but says there are better ways for the province to achieve its objectives.

The study was ordered following the provincial budget of May 13, 1982. At that time the Treasurer of Ontario asked the Council to investigate and report upon the following question: "What would be the economic implications if the Province of Ontario were to withdraw from the present Tax Collection Agreement with the federal government and institute its own Personal Income Tax collection system?"

The study was authored by Douglas G. Hartle, Professor, Department of Economics, and Research Associate, Institute for Policy Analysis, University of Toronto, and Consultant, Ontario Economic Council.

Professor Hartle assembled the research team and his role was also to oversee its work. He incorporated this material into an integrated background volume. It provided the basic building blocks for the Ontario Economic Council's official position paper on the Treasurer's Reference, A Separate Personal Income Tax for Ontario: An Ontario Economic Council Position Paper.



The study points out that the existing joint Canada-Ontario personal income tax (PIT) system is not doing the best it can for either the province or the federal government. It says modifications must be made to accommodate the needs of the provinces.

Ontario has unique social and economic circumstances, and the report says the federal PIT system has failed to deal adequately with these social and economic differences. This report says that many of Ontario's concerns can be overcome by the institution of several basic reforms in the present tax system.

The current tax agreement is on shaky ground.

There is no doubt that the federal government has been cavalier and pre-emptive in the field of personal income taxation. Unilateral changes that affect the interests of Ontario have been made by Ottawa without warning, much less consultation, despite the fact that Ontario's jurisdiction with respect to PIT is unquestioned. Some of these changes have created serious problems, certainly some of a political and probably of an economic nature.

"Unless Ottawa is prepared to substantially alter its decision-making process with respect to changes in personal income taxation, it will place in increasing jeopardy the goal of fiscal harmonization that it has pursued since the Second World War. Whether the federal government will be willing to amend its decision-making process to accommodate the provinces is moot. But it is a point that in a sense overrides the whole question addressed in this report. The required changes are not simply mechanical procedural modifications, but changes in the weight given to the views and interests. In short, a change in the federal political system is involved."

Ontario has a need for bargaining leverage on tax and other matters vis-à-vis the federal government.

Professor Hartle puts it this way: "The exigencies of political life are such that provincial treasurers and the governments of which they are a crucial part cannot be made to appear silent parties to



federal tax changes that are perceived to be antithetical to the interests of their supporters. Nor can they easily sustain their credibility when their views are seen to be either ignored or given no more weight than those of other 'special interest' groups. In short, the development of a legitimate form of 'due process' with respect to the way in which federal personal income tax changes are decided may well be as important or more important than the actual substance of the federal changes, at least from the perspective of provincial treasurers. And in the final analysis, day-to-day political necessities are likely to carry more weight than the abstract virtues of tax harmonization, common markets, and similar verities."

There is an urgent need to give the provinces greater access to the federal tax structure decision-making process in order to reduce the likelihood of the provinces 'going their own way' for political rather than for economic reasons.

#### Why not a separate and unique Ontario PIT?

- The adoption of a separate and presumably different personal income tax system by the province of Ontario would bring additional costs: the additional tax planning and compliance cost of taxpayers and employers, and the additional administrative costs of collection.

THE ADDITIONAL COSTS OF COLLECTING AN ONTARIO PIT, INCLUDING COMPLIANCE AND ADMINISTRATIVE COSTS, ARE ESTIMATED TO BE BETWEEN \$180 AND \$385 MILLION.

(See Chapters 4 and 5 of the report for a detailed explanation of costs involved with a separate PIT.)

- The effects of alternative PIT structures on labour supply, personal saving, and business investment are not known for certain. There are both analytical and strategic uncertainties about the effectiveness of possible PIT changes under a separate PIT system.

(See Chapter 8 re: Labour Supply, Chapter 10 re: Personal Saving, and Chapter 11 re: Business Investment.)

- If Ontario were to adopt unique PIT provisions they might be perceived to be attempts at 'province building' at the expense of the residents of other jurisdictions.

'Other jurisdictions would likely try to emulate the Ontario provisions or to inflict retaliatory "punishments" on the residents of Ontario. PIT provisions that were likely to have a significant negative effect on the residents of other provinces would also be likely, sooner or later, to provoke retaliatory moves that would offset or more than offset any benefit that Ontario might gain from them.'

Professor Hartle says, 'Zero sum games often become negative sum games: the struggle for bigger shares of a pie usually wastes some of the pie.'

He says, 'Ontario Building' at the expense of those outside the province is ruled out as an option in this report.

The report recommends we stay within the Federal PIT system. It says there are problems with the existing system, but it is more worthwhile to modify the system than to adopt a new one with new problems that are potentially greater than the others.

A separate PIT for Ontario is not recommended because there are some changes that probably could be made in the existing system, still with federal collection, that would produce the desired effect. These include:

- 1) A Federal-Provincial tax structure committee which would allow joint input into the determination of the common tax base.
- 2) A move toward a 'tax on base' as opposed to the present 'tax on tax' system. (See Chapter 2 for detailed explanation.)



- 3) An extension of the tax credit system to provide the province with more freedom to implement non-discriminatory measures within their portion of the joint PIT. (See Chapter 2 pgs. 76-98.)

This volume constitutes the second tier of the Ontario Economic Council's response to the Treasurer of Ontario. A final volume of individual background studies, edited by the Council's Research Director, Dr. David Conklin, will be forthcoming.

FOR FURTHER INFORMATION CONTACT:

David Conklin, Research Director and  
Executive Secretary

(416) 965-4315

Douglas Hartle

(416) 978-8628

A Separate Personal Income Tax for Ontario: An Economic Analysis, 654 pages, price \$10.00, is available at the following outlets:

The Ontario Government Bookstore, 880 Bay Street, Toronto, to those shopping in person. Out-of-town customers may write: Publications Section, Fifth Floor, 880 Bay Street, Toronto, Ontario, M7A 1N8, or telephone 965-6015 (toll-free long distance, 1-800-268-7540; in northwestern Ontario, 0-Zenith 67200). A cheque or money order, payable to the Treasurer of Ontario, must accompany all mail orders.

Renouf Publishing Company, Limited, 61 Sparks Street, Ottawa, Ontario K1P 5A6, telephone (613) 238-8985.

The Bookstore, Windsor Public Library, 850 Ouellette Avenue, Windsor, Ontario, N9A 4M9, telephone (519) 255-6765.

